(38) (16)

Nos. 92-1384 and 92-1839

In The

Supreme Court of the United States

October Term, 1993

No. 92-1384

BARCLAYS BANK PLC,

Petitioner,

v.

FRANCHISE TAX BOARD,
AN AGENCY OF THE STATE OF CALIFORNIA,

Respondent.

No. 92-1839

COLGATE-PALMOLIVE COMPANY,

Petitioner,

v.

FRANCHISE TAX BOARD,
AN AGENCY OF THE STATE OF CALIFORNIA,

Respondent.

**On Writ Of Certiorari To The
Court Of Appeals Of The State Of California,
In And For The Third Appellate District**

AMICUS CURIAE BRIEF OF CITIZENS FOR TAX JUSTICE IN SUPPORT OF RESPONDENT FRANCHISE TAX BOARD

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QUESTIONS PRESENTED

1. Whether California's application of worldwide combined reporting to determine the taxable income of domestic corporations with foreign parents, or foreign corporations with either foreign parents or foreign subsidiaries, is unconstitutional under the foreign Commerce Clause.

2. Whether California's application of worldwide combined reporting to determine the taxable income of domestic corporations with foreign parents, or foreign corporations with either foreign parents or foreign subsidiaries, intrudes into an inherently federal area and is pre-empted by the United States Constitution.

3. Whether California's application of worldwide combined reporting to determine the taxable income of domestic corporations with foreign parents, or foreign corporations with either foreign parents or foreign subsidiaries, is unconstitutional under the Commerce Clause where such application imposes discriminatory compliance burdens on such entities.

4. Whether California's system for compliance with worldwide combined reporting violates the Due Process Clause of the United States Constitution where compliance is not possible without undue cost and the system, to function, depends on discretionary relief provisions without constitutionally sufficient standards to guide application and prevent arbitrary enforcement.

QUESTIONS PRESENTED – Continued

In its *Amicus Curiae* Brief, Citizens for Tax Justice shall address only the first two questions set forth above.[1]

[1] *Amicus* Citizens for Tax Justice has received consent from all parties to file this brief and will file written confirmation of those consents with the Clerk of the Court.

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STATEMENT OF INTEREST OF AMICUS CURIAE CITIZENS FOR TAX JUSTICE

Citizens for Tax Justice (CTJ) is a coalition of national public interest organizations, labor unions, and citizens groups around the country. CTJ was founded in 1979 and is headquartered in Washington, D.C.. Through its member organizations, CTJ represents the interest of tens of millions of middle and lower-income taxpayers. Several of CTJ's members also represent state and local government workers around the country, including California.

As a representative of middle and lower-income taxpayers and of state and local government workers, CTJ has a vital interest in the outcome of the cases before the Court. The decision of the Court in these cases will affect the right of California and other states to assess a fair share of the tax burden on multinational corporations that do business in those states. The pending cases will therefore directly affect both state and local taxpayers and state and local government workers, since a decision against the State of California in these cases is likely to mean increased personal taxes, reduced government services or both in the states which are affected.

SUMMARY OF ARGUMENT

This case involves an issue that the states fought – and won – in the negotiations over the U.S.-U.K. tax treaty. Essentially, Petitioner Barclays Bank PLC (hereinafter "Barclays") is asking this Court to renegotiate the U.S.-U.K. tax treaty by holding that it is unconstitutional for California to apply worldwide combined reporting (WWCR) to members of a unitary business controlled by Barclays, a British corporation. Yet both the United States and the United Kingdom consented to the application of WWCR in exactly this situation when they entered into the U.S.-U.K. tax treaty.

To be sure, an earlier, unratified version of the treaty, negotiated by the Executive branch, contained an unprecedented provision that would have prevented the application of worldwide combined reporting (WWCR). Exercising its Constitutional powers, the Senate refused to ratify this version of the treaty.

The Executive branch could obtain Senate approval only after this restriction on WWCR was removed from the treaty. In order to compensate the United Kingdom for the continued right of the states to use WWCR and in order to induce it to enter into a treaty that permitted WWCR, the Executive branch made concessions to the U.K. in other provisions of the treaty. The Senate then ratified the treaty with these concessions and without any restrictions on WWCR. These events, as well as statements by both governments, make it perfectly clear that the United Kingdom and the United States recognized that states could apply WWCR to a taxpayer such as Barclays. Indeed, Barclays is not claiming that California's use of WWCR violates the treaty.

This Court is now being asked to do what the United Kingdom and the Executive branch of the United States government could not do through the treaty process and outlaw WWCR. But the Senate is the proper body to renegotiate the treaty. Only through renegotiation of the treaty could the Senate reclaim the concessions that were

previously made to the United Kingdom as a quid pro quo for WWCR.

The Executive branch and the United Kingdom made the best bargain they could at the time in light of the Senate's sentiments. Certain past and current officials in the Executive branch have been unhappy with the treaty's resolution of the WWCR issue and have attempted through the political process to curtail this method of taxation. They have been notably unsuccessful in convincing the Legislative branch of the government to exercise its Constitutional powers to regulate interstate and foreign commerce by passing legislation governing WWCR. They have been more successful in using political suasion in encouraging states to curtail voluntarily their taxing powers. In response to these pressures, California has abandoned the mandatory use of WWCR. The Court should find that, under the facts presented in these cases, the federal government has not abandoned, by law, policy or action, its approval of California, or any other state's right, to impose WWCR should it determine to do so.

ARGUMENT

NEGOTIATIONS OVER THE U.S.-U.K. TAX TREATY MAKE IT CLEAR THAT BOTH THE UNITED STATES AND THE UNITED KINGDOM AUTHORIZED THE APPLICATION OF WORLDWIDE COMBINED REPORTING TO CORPORATIONS SUCH AS BARCLAYS

The events surrounding the ratification of the U.S.-U.K. tax treaty make it clear that both the United States and the United Kingdom authorized the application of WWCR to corporations such as Barclays. The California tax on Barclays is consistent with the treaty and reflects the understanding of both countries. Because WWCR is consistent with the treaty, which is the supreme law of the land, it cannot be invalidated under a dormant foreign commerce clause analysis.

In 1975, the Executive branch negotiated a revision of the existing tax treaty with the United Kingdom. Article 9(4) of this proposed revision would have barred California (and other states with similar tax regimes) from imposing WWCR on British corporations such as Barclays.[2] The proposed Article 9(4) was recognized by all parties to be an attack on WWCR. For example, the Treasury Department's June 8, 1976 submission of this version of the treaty to the President stated:

> "This provision represents the first attempt to bind State and local taxing authorities by a substantive provision of the treaty (other than nondiscrimination). Under the basic rules of our other tax conventions a contracting State entering into such tax conventions is prohibited from taking into account, in determining the tax liability of an enterprise doing business in that contracting State, the income, expenses, etc. of related enterprises of the other contracting State, or in other countries of those enterprises if those enterprises are not engaged in business in the contracting State, except to the extent that

[2] Article 9(4) in the final treaty does not bar either the United States or the United Kingdom from extensively using formulary apportionment within the context of an arm's length standard. This aspect of Article 9(4) was uncontroversial.

> inter-company transactions are not conducted on an arm's length basis. This treaty, for the first time, extends this limitation to State and local tax authorities with respect to enterprises controlled by United Kingdom residents. This limitation is directed at the practice of a few states which are attempting to take into account the income on a consolidated basis of all related foreign enterprises in assessing the State income tax of a single member of the related group doing business in the State."[3]

This unprecedented attempt to limit state taxation touched off a heated and extensive debate. Ultimately, the treaty could not be ratified without a reservation to this part of Article 9(4).

The Senate's reservation was a blow to the United Kingdom, whose business community felt strongly about obtaining a prohibition on WWCR. The reservation also foiled the United Kingdom's attempt to use the treaty to circumvent Congress' consistent refusal to enact legislation outlawing WWCR. Such legislation had been debated for ten years prior to the introduction of the U.K. treaty; even in the midst of debate over the treaty there were suggestions to substitute a legislative response for Article 9(4), but the Congress adamantly refused to interfere with the taxing power of the states.[4]

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[3] Reprinted in P-H Tax Treaties, United Kingdom – Income Tax Treaty, at 89,050 (1976).

[4] For some of the bills that would have, inter alia, affected the states' use of WWCR, see H.R. 11798 (1965); S. 916 (1969); S. 317 (1971); S. 4080 (1972); S. 2173 (1977); S. 1688 (1979); H.R. 5076 (1979); H.R. 5903 (1979); H.R. 8277 (1980); H.R. 1983 (1981);

The Senate's ratification of the treaty with a reservation to Article 9(4) raised doubts about whether the British would sign the revised treaty. In addition to the strong business opposition in the United Kingdom to the reservation, there was concern over the growing cost of a retroactive refund to U.S. investors of the British Advance Corporation Tax, which the proposed treaty provided.[5] Not surprisingly, the British requested additional concessions for the Senate's refusal to prohibit WWCR[6] and the Executive branch entered into further negotiations with the United Kingdom. To induce the British to enter into the treaty with the Senate reservation and to compensate them for the states' use of WWCR, the Executive branch made concessions to the British in other provisions of the treaty.[7] These changes were reflected in

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H.R. 6402 (1982); H.R. 2918 (1983); H.R. 3243 (1983); S. 1225 (1983); H.R. 4940 (1984); H.R. 6146 (1984); S. 3061 (1984); H.R. 3980 (1985); S. 1113 (1985); S. 1974 (1985).

[5] Third Protocol to the 1975 Income Tax Convention with the United Kingdom of Great Britain and Northern Ireland, as Amended, Report of the Committee on Foreign Relations, United States Senate on Executive Q, 96th Cong., 1st Sess., p. 47 (June 15, 1979). It was estimated that the retroactive refund would cost over $500 million through 1979. *Id.*

[6] According to Donald C. Lubick, Assistant Secretary for Tax Policy, "it was reasonable to expect the British to request some additional concession for the loss of the benefits of Article 9(4) . . . " *Id.* at 46.

[7] Donald C. Lubick, Assistant Secretary for Tax Policy, stated that "The British authorities view some of the provisions of the Third Protocol (particularly the North Sea permanent establishment rules) as a concession for the deletion of Article 9(4)." *Id.* at 46. The British Treasury Chief Secretary stated upon adoption of the Treaty: "the United Kingdom, recognizing the

the Third Protocol to the Treaty. As the Senate prepared to vote on the Third Protocol, it understood that it faced the following policy choice: if the treaty were to be approved, there could be no prohibition on WWCR; with such a prohibition, the treaty would not be ratified.[8] The Senate ratified the revised treaty with no prohibition on the states' use of WWCR by voting unanimously in favor of the Third Protocol. The Report of the Senate Foreign Relations Committee leaves no doubt that both the United States and the United Kingdom interpreted the treaty as authorizing the use of WWCR:[9]

> "Under the protocol, political subdivisions and local authorities of either country are free to use formula methods to apportion income, deductions, and other items among related enterprises in determining income subject to their taxes, so long as such methods do not violate the proposed treaty's nondiscrimination provisions (Article 24)."

California's use of WWCR is clearly within the bounds of this authorization because it does not violate the treaty's nondiscrimination clause, nor does either Petitioner allege such a violation.

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difficult constitutional problem in the United States which the application of Article 9(4) to individual State taxes posed and the *compensatory offer* which the United States has made, has acquiesced in the Senate reservation but has done so only with the greatest reluctance." Quoted in Kane, James M., "International Tax Treaties and State Taxation: Can the Federal Government Speak with One Voice?", 10 VIRGINIA TAX REVIEW 765, 781 (1991) (emphasis added).

[8] See 125 Cong. Rec. 17427-34 (July 8, 1979).

[9] *Supra* note 5 at 5.

Notwithstanding the unambiguous statements made by officials in both the United States and the United Kingdom that they understood the treaty as authorizing WWCR, and despite the United States "paying" for WWCR by making further concessions to the British, Petitioners would prefer an explicit statement authorizing WWCR in the body of the treaty. This requirement would impose a near impossible standard because neither the Senate nor the entire Congress is in the business of expressly reaffirming state taxing powers and there was no reason to start doing so in the U.S.-U.K. treaty.

First, the British obviously had no reason to demand such a statement. Neither, however, did the states. The whole debate over Article 9(4) proceeded on the assumption that the states had the right to impose WWCR unless otherwise restricted by the treaty (or federal legislation). Second, no tax treaty before or after the U.K. treaty has ever reaffirmed a state taxing power. Considerations of fiscal federalism have removed such powers from the purview of tax treaties. It would have been unprecedented for a tax treaty to have provided authorization for WWCR (or, for that matter, to provide for any other similar feature of state taxation). Third, an explicit provision in the U.K. treaty authorizing WWCR would have raised a negative inference about the constitutionality of other aspects of a state's tax regime, such as the taxation of foreign source dividends.

Nor do the recent cases of this Court demand that the treaty contain an express affirmation of WWCR. For example, the present case presents a more compelling situation than did *Wardair Canada, Inc. v. Florida Dept. of Revenue*, 477 U.S. 1 (1986) for finding that "the Federal

Government has affirmatively acted, rather than remained silent, with respect to the power of the States to tax . . . and thus that the case does not call for dormant foreign commerce Clause analysis at all." *Id.* at 9. *Wardair* upheld Florida's excise tax on fuel purchased by a Canadian airline for use exclusively in foreign commerce. In *Wardair*, the taxpayer argued that there was a federal policy to exempt the purchase of such fuel and that the Florida tax interfered with the government's ability to speak with one voice.

In support of its position, Wardair cited the Chicago Convention on International Civil Aviation, which precluded the imposition of local taxes on fuel only when the fuel was already on board an aircraft on arrival and retained on board on leaving; the Convention did not address the taxation of fuel purchased locally after arrival. *Id.* at 10. The Court held:

> "that the negative implications of this provision support recognizing Florida's power to tax; certainly, the provision demonstrates the international community's awareness of the problem of state and local taxation of international air travel, specifically aviation fuel, and represents a decision by the parties to that Convention to address the problem by curtailing and limiting only some of the localities' power to tax, while implicitly preserving other aspects of that authority." *Id.* at 10.

The facts in *Barclays* present an even stronger case in favor of upholding the California tax than did the facts in *Wardair* for upholding the Florida tax. The exhaustive debate over Article 9(4) in the U.S.-U.K. treaty, the earlier

legislative attempts to deal with WWCR, and the reservation by the Executive branch to the 1963 and 1977 OECD Model Treaty clause[10] that would have had the effect of prohibiting state use of WWCR, demonstrate the international community's long-standing awareness of the problem. The Senate's reservation, combined with the concessions made to the United Kingdom, represent a decision by the parties to address the problem by preserving the states' power to tax. Even before *Wardair*, the Court recognized that where there has been ample debate over a tax issue, Congress' preservation of the status quo by refusing repeatedly to adopt legislation is support for concluding that Congress has acquiesced in the *status quo*.[11]

There are other strong parallels with *Wardair*. In *Wardair*, the Court said:

> "[m]ost strikingly as it relates to the case before us, the U.S.-Canadian Agreement itself limits the tax exemption to be afforded to foreign air carriers to 'national duties and charges.' Taxation by political subdivisions of either the United States or Canada are not mentioned, an

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[10] 1963 and 1977 OECD Model Income Tax Treaties and Commentaries: A Comparative Presentation (1987), at 16-17.

[11] See *Bob Jones University v. United States*, 461 U.S. 574, 600 (1983). The only difference between *Wardair* and *Barclays* is that in the former there was a provision precluding some local taxation of fuel whereas in the latter the prohibition is more general in that a state tax cannot be discriminatory. But this difference is irrelevant because the entire debate over WWCR leaves no doubt that the treaty was intended to permit the continued state use of WWCR.

> omission which must be understood as representing a policy choice by the contracting parties . . . ". *Wardair*, at 11.

Article 9(4) of the U.S.-U.K. treaty, similar to the U.S.-Canadian agreement, speaks only to national taxes. Taxation by political subdivisions of the United States is not mentioned in the U.S.-U.K. tax treaty, an omission that, in the context of the robust debate over Article 9(4), represents a clear, bargained for, policy choice by the contracting parties.

In *Wardair* the Court concluded that

> "[w]hat all of this makes abundantly clear is that the Federal Government has not remained silent with regard to the question whether States should have the power to impose taxes on aviation fuel used by foreign carriers in international travel. By negative implication arising out of more than seventy agreements entered into since the Chicago Convention, the United States has at least acquiesced in state taxation of fuel used by foreign carriers in international travel. Again, in the U.S.-Canadian agreement only 'national' charges are barred, and we presume that drafters from two federalist nations understood this as representing a choice not to preclude local taxation." *Id.* at 12.

Obviously, the debate over Article 9(4) and the Senate reservation represents a similar choice not to preclude the use of WWCR by the states. And, as was true in *Wardair*, in all the treaties negotiated since the U.S.-U.K.

treaty – more than 20 of which have already been signed[12] – the United States has never tried to impose any restrictions on the states' use of WWCR. The U.S.-U.K. tax treaty in particular, and the entire 25 year debate over WWCR starting in the early to mid 1960s,[13] would hardly qualify as Congressional silence. To the contrary, there has been a strident and contentious debate over whether to curtail WWCR.

The legislative history of the U.S.-U.K. treaty demonstrates what the expectations of the parties were. Accordingly, there is no need for the Court to address whether, in the absence of the U.S.-U.K. treaty, the foreign commerce clause would invalidate California's tax. "It would turn dormant Commerce Clause analysis entirely upside down to apply it where the Federal Government has acted, and to apply it in such a way as to reverse the policy that the Federal Government has elected to follow." *Wardair*, at 12. "[T]he Federal Government is entitled in its wisdom to act to permit the States varying degrees of regulatory authority." *Id.*

To be sure, some former officials in the Executive branch have challenged the wisdom of the Legislative branch in permitting worldwide combined reporting. They pressed their concerns through press releases, speeches, *amicus* briefs, letters, political suasion, and attempts to pass legislation. They did not, however,

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[12] See Tax Analysts, WORLDWIDE TAX TREATY INDEX, May 1993, at 85-92; 8 TAX NOTES INT'L, 36 (January 3, 1994).

[13] The debate can be marked as either starting with H.R. Rep. No. 1480, 88th Cong. 2nd Sess. (Willis Committee report) in 1964 or with the introduction of H.R. 11798 in 1965.

attempt again to use the treaty mechanism to prohibit WWCR because they recognized that the Senate would not ratify any treaty containing such a provision.[14]

Consistent with *Wardair*, these Executive branch complaints deserve no legal weight. They carry even less weight than a Resolution adopted by the International Civil Aviation Organization, which the taxpayer cited in *Wardair* in support of its position that the Florida tax should be struck down under the dormant foreign commerce clause. The Court characterized the resolution as "an international aspiration on the one hand to eliminate all impediments to foreign air travel . . . ". *Wardair* at 10. The Court described the Resolution as "formally merely the work product of an international organization of which the United States is a member; it has not been specifically endorsed, let alone signed, entered into, agreed upon, approved, or passed by either the Executive or Legislative Branch of the Federal Government. In other words, no action has been taken to give the Resolution the force of law."[15] *A fortiori*, complaints by former officials in the Executive branch that do not even rise to the level of an International Resolution should not carry any more authority than the Resolution did in *Wardair*. Complaints about WWCR may represent "aspirations" but

[14] Statement of Donald C. Lubick regarding the United States Model Tax Treaty, Hearings before the Committee on Foreign Relations, United States Senate, 96th Cong., 1st Sess. (June 6, 1979), p. 112.

[15] *Id.* at 11. The closest parallel to the Resolution is the OECD Model Tax Treaty. The United States, however, has taken a reservation to that part of the Model that would have applied to subnational taxes. See *supra* note 10.

until acted upon by the Legislative branch through a treaty or legislation remain just that – aspirations.

Itel Containers International Corp. v. Huddleston, 113 S. Ct. 1095 (1993), lends yet additional support to California's position. In *Itel*, the federal government had adopted various conventions, statutes, and regulations, restricting the ability of the states to tax international cargo containers in defined circumstances. State taxes collected in connection with the importation of cargo containers were also prohibited. The sales tax at issue in *Itel* did not fall within those proscriptions, "and the most rational inference to be drawn is that [the Tennessee sales tax], one quite distinct from the general class of import duties, is permitted." *Id.* at 1105. *Barclays* presents a much easier case than *Itel*; there is no proscription against WWCR for reasons that are well documented. WWCR does not fall within any of Article 9(4)'s constraints on WWCR, which apply only to the United States and the United Kingdom,[16] because of the bargain struck between the two countries. Moreover, *Barclays* is not a situation in which there is "congressional authorization for [WWCR] in congressional silence."[17] The vociferous debate over Article 9(4) is hardly tantamount to Congressional silence.

[16] See *supra* note 2.

[17] *Itel* at 1110 (Blackmun, J., dissenting).

CONCLUSION

The U.S.-U.K. treaty was understood by the signatories as permitting WWCR. The Court's recent decisions in *Wardair* and *Itel* merely underscore that conclusion. Accordingly, this Court should affirm the judgments below.

Respectfully submitted,

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